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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER APRIL 7 2006
ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- SA's Inflation Shows Signs of Growth Although Should Remain Within Targets;
- Manufacturing Sector Shows Signs of Fragile Recovery;
- Higher Corporate Tax Collection Reduces Federal Deficit Even Further;
- NAAMSA Reports March Vehicle Sales Still Strong;
- Business Confidence Improves Slightly in March;
- Survey Shows 2005 South African FDI Higher than India's;
- House Price Inflation Moderates;
- January Retail Sales Slow; and
- Clarification on Synthetic Fuel Tax and Mine Royalties.

End Summary.

SA's Inflation Shows Signs of Growth Although Should Remain Within Targets
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¶2. South African inflation is trending higher, although it should remain within the South African Reserve Bank's (SARB) target band of 3%-6%. SARB's main challenge, apart from external factors such as the oil price, is credit growth, which shows no signs of abating, and is slowly becoming more of a threat to inflation. Credit growth increased 21.5% y/y in February compared to January's 20.6% growth, driven higher by strong demand for mortgage advances. Money supply (M3) increased 21% in February, compared to January's increase of 19.7%. SARB Governor Tito Mboweni commented that interest rates would probably not be reduced when the monetary policy committee meets later in April. Source: Business Day, April 3.

Manufacturing Sector Shows Signs of Fragile Recovery
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¶3. Investec's Purchasing Managers Index (PMI), a measure of manufacturing activity, rose to 51.5 in March from 49 in February, slightly above the 50 breakeven value indicating that half of the respondents expect improvement in business activity and half do not. According to Andre Roux of Investec Asset Management, the slight depreciation of the rand during March improved both the export performance of manufacturers as well as the degree of import competition. Most of the sub-components of the PMI

contributed to the rise in March, with the seasonally adjusted business activity index gaining by 7 index points to 54.9. New sales orders improved to 53.3 from 49 in February. The employment index rose to 48.2 from 45.8 in February, although most survey respondents still expect no overall increase in manufacturing jobs. Managers' purchasing commitments improved further, with the index climbing to 54 from 48.9 in February, which indicated that managers were buying into the improved conditions within the sector. However, short-term (6-month) expectations regarding general business conditions deteriorated during March, with the expectations index decreasing from 71.4 in February to 68.4. Source: Reuters, April 3; Business Day, April 4.

Higher Corporate Tax Collection Reduces Federal Deficit Even Further
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¶4. South Africa collected more than R1 billion more than the February 2006 estimate of R417 billion ($70 billion, using 6 rands per dollar) due to higher than expected corporate tax collections through the end of its fiscal year 2005/06. As of the March 31 end of the financial year, the South African budget deficit was 0.3% of GDP, closer to a balanced budget than February's estimate of 0.5%. In February 2005, the National Treasury estimated that tax collections would be R372.8 billion, R45.3 billion lower than the actual amount collected. Personal income tax collections were R125.4 billion below February's 2006's estimate of R126.5 billion. However, according to the South African Reserve Bank's latest quarterly bulletin, compensation of employees slowed in 2005 to 8.9% from 9.4% in 2004. Manuel said that the initial target of R372.8 billion was based on a set of



macroeconomic assumptions that improved over 2005. Source: Business Day, April 4.

NAAMSA Reports March Vehicle Sales Still Strong
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¶5. According to the National Association of Automobile Manufacturers of SA (NAAMSA), March new vehicle sales increased 29.1%, y/y, and on a month-on-month basis, the sales increased 15.8%, compared with February 2006. New vehicle sales reached 56,341 units in March. However, analysts warn that March sales figures may seem overly optimistic. In 2005, the Easter holidays happened in March rather than in April when it occurs in 2006, which would inflate March 2006's growth. Tony Twine, a motor industry analyst and director of Econometrix, estimates that about 12 percentage points of the new vehicles sales growth is attributable to Easter being in March last year. NAAMSA increased its growth projections for 2006 from the previous 10% to between 15% and 20% due to a positive macroeconomy, strong business and consumer confidence, relatively low interest rates and vehicle affordability. During March, all vehicle segments increased including passenger vehicles, trucks and buses. NAAMSA expects that strong investment and government spending on infrastructure would support growth in sales of medium and heavy commercial vehicles. Vehicle exports for the first two months of 2006 were 7,869 units higher (54.4%), than exports in the first two months of 2005. Source: Business Day and Business Report, April 5.

Business Confidence Improves Slightly in March
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¶6. The South African Chamber of Business's (SACOB) business confidence index rose slightly in March to 100.9 from February's 100.1, although there were fewer categories showing positive growth compared to the previous two months. The index is made up of 13 sub-

indices representing economic indicators that affect the business mood. Among the sub-indices are manufacturing production, liquidations, inflation, the real prime overdraft rate, the gold price and the rand exchange rate. In March, the sub-indices on the exchange rate, inflation and manufacturing output contributed negatively to the confidence index, as did the liquidations sub-index. SACOB expects that growth in gross domestic spending will moderate in 2006. Source: Business Day, April 5.

Survey Shows 2005 South African FDI Higher than India
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¶7. According to an Ernst & Young survey, the value of mergers and acquisitions in South Africa increased 63% in 2005, leading to South Africa's foreign direct investment (FDI) to be higher than India's 2005 FDI. Mergers and acquisitions reached R269 billion in 2005, including Old Mutual's R38 billion takeover of Skandia, Barclays' R30 billion purchase of Absa and Vodafone's R21 billion acquisition of Venfin shares. R57 billion of the R269 billion was inward investment or FDI, equal to the foreign investment of the previous five years combined. South Africa's FDI was smaller than China's or Brazil's 2005 FDI but was larger than India's for the first time in surveys sponsored by Ernst & Young. The Ernst & Young survey is one of two major gauges of mergers and acquisition in South Africa, alongside that of Dealmakers. Using different criteria, Dealmakers put the total value of mergers and acquisitions at R351 billion in 2005. Source: Business Day, April 5.

House Price Inflation Moderates
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¶8. House price inflation continues to moderate, with ABSA's house-price index growing nominally at 13.7% y/y in March, compared to 14.6% in February, the lowest growth rate since February 2002. The average middle segment house price is now at R765,400 ($127,600). In real terms, February house prices increased 10.3% y/y from January's 10.9% growth. ABSA expects the average nominal house inflation in 2006 to be 12% compared to 2005's inflation of 22.1%. Source: Business Day, I-Net Bridge, April 5.



January Retail Sales Slow
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¶9. According to Statistics SA, retail sales increased 5.6% y/y in January 2006 compared to December's 8.5% growth. Consumer demand has supported higher economic growth in South Africa over the past two years, helped by low nominal interest rates, inflation and an emerging black middle class. The South African Reserve Bank (SARB) reduced its key repurchase rate by 6.5 percentage points to 7% between 2003 and 2005, driving prime lending rates to a 25-year low of 10.5%. SARB has repeatedly cited strong domestic consumption as one of the risks to an otherwise benign inflation outlook. Source: Reuters, April 5; Business Report, April 6.

Clarification on Synthetic Fuel Tax and Mine Royalties
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¶10. Finance Minister Trevor Manuel established timeframes for two tax measures, committing the National Treasury to release a new draft of the mining royalty bill by mid-May. He also promised to announce in mid-April a task team that would examine possible imposition of a windfall tax on synthetic fuels. The original draft of the Minerals and Petroleum Royalty Bill was released for public comment in March 2003 and a final draft was expected three years ago. South Africa's new Mining Act is based on the principle that South Africa's mineral rights belong to the nation

and can only be leased by private companies, which must pay royalties for the right to exploit the resources. The royalty bill proposed levying royalty taxes ranging from 1%-8% of sales revenue, depending on what was being mined. The proposals drew intense criticism from mining companies and investors on the grounds that they would cut profit margins and reduce investment in the industry, particularly in new projects. In addition, many of South Africa's diamond and gold mines are aging and marginal. Hence an additional revenue tax could push many marginal properties into closure, with the consequent job and export revenue losses. The proposal that the royalties would be levied on mines' gross sales revenue, rather than on their profits, generated far more controversy than the rates themselves. Though there have been indications that government might cut the royalty rates, it is not clear whether it is open to changing the basis from sales to profits.

¶11. The February 2006 National Treasury Budget Review noted that the synthetic fuel industry, which accounts for about 35% of South Africa's domestic liquid petroleum sales, could receive substantial economic rents when crude oil prices were high. The review also pointed out that these windfall gains should be shared with the public since the synthetic fuel industry had developed with extensive government support. Manuel announced the task force would examine imposing windfall taxes on the synthetic fuel industry. Source: Business Day, April 4.

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